ACD Systems International Inc.

2006 Annual Report

2006 ANNUAL REPORT

“Our plan is to offer what the competition cannot. ACD will provide what customers want and need to simplify their digital photo experience. With our products and services, people will spend less time working against technology and more time taking, enjoying and sharing their pictures.”

Message to Shareholders

Results for this fiscal year clearly show that ACD’s decision to change its business model has been the right choice. We have launched two initiatives, one addressing necessary adjustments to our core desktop software business, and the other an aggressive move toward maximizing the value of ACD’s extensive and longstanding global brand awareness and user base.

The first initiative is focused on stabilizing the revenue from mature core products while rolling out new desktop products that address the needs of our existing user base and new customers. One of the new desktop products is a photo editor derived from the combined technologies of ACDSee™ and Canvas™, which will be released in the fall of 2006. Having a complete suite for photo management and editing will improve our competitive position and ability to grow revenue in the desktop software market.

The second initiative extends our core technologies onto the internet by combining the rich technology of our desktop products with the global ACDSee brand to form a high-quality online services offering. Our users will be invited to join this community by creating a personal portal, through which they can discover how much easier and more enjoyable digital photography can be. Our goal is to transition a large number of people from our desktop business to this new community-oriented, service revenue model over the next three years.

These two initiatives are complementary, ultimately strengthening both the desktop software business while bringing new service based revenue to ACD. The products for both initiatives are powerful tools derived from the technology and talent at ACD.

Operational improvements last year were significant and will continue as we execute on the new initiatives. Our goal is to hit maximum operating efficiency this year.

Competition in our market will continue to increase. As the majority of the world’s population moves from traditional film processing to digital cameras, digital photos have become a strong motivator for consumers to own a computer and spend money on Internet services. Microsoft and Apple realize the importance of this market and will be releasing desktop products leveraging their operating systems. Google and Yahoo will also compete to attract users to their online platforms.

Our plan is to offer what the competition cannot. Not being restricted by the broad objectives of the big competitors provides an opportunity for a small company to address the fundamental needs of a growing digital photo industry in a simple, direct and efficient manner. ACD will provide what customers want and need to simplify their digital photo experience. With our products and services, people will spend less time working against technology and more time taking, enjoying and sharing their pictures. ACD’s product and service offerings will be valuable assets for today’s digital photo enthusiast.

Douglas Vandekerkhove

ACD Systems International Inc.

Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations Period Ended March 31, 2006

ACD Systems International Inc.

Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations
Period ended March 31, 2006

Forward-looking information

The following discussion contains forward-looking statements that are subject to significant risks and uncertainties. A number of important factors could cause actual results to differ materially from historical results and percentages, and results anticipated by the forward-looking statements contained in the following discussion. Such factors and risks include, but are not limited to, intense competition and rapid change in the software industry, including price and product feature competition; the introduction of new products by existing or new competitors; the economic environment; dependence on distributors and the emergence of new distribution channels; the timing and customer acceptance of new or upgraded products; and the ability to develop, market, support and acquire new products in an environment of rapidly changing technology. Readers should carefully review the risks described herein and in the other documents ACD Systems International Inc. ("ACD" or the "Company") files from time to time with the British Columbia, Alberta, and Ontario Securities Commissions.

Overview

This MD&A is dated June 16, 2006 and should be read in conjunction with the Company's March 31, 2006 annual audited consolidated financial statements and notes. The Company reports its annual audited consolidated financial statements and notes in Canadian dollars, and in accordance with Canadian generally accepted accounting principles ("GAAP"). GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Included in the financial statements is a note reporting the March 31, 2006 financial results in accordance with U.S. GAAP. The consolidated Canadian GAAP financial statements are included in the Annual Report to Shareholders.

Information relating to the Company, including its most recent annual information form, is available on SEDAR at www.sedar.com.

ACD develops and markets sophisticated file management and technical imaging products including the proprietary software products ACDSee™ and Canvas™. The software uses a design that combines a wide range of high performance functions. The software is available as a pre-packaged, bundled software or can be downloaded using the Internet. ACDSee™ is an easy-to-use digital image viewing and management tool. It provides a wide range of features that are suited to personal and professional use. ACDSee™ is a consistent award winner and has been recognized in industry and business publications worldwide including product reviews in hundreds of trade magazines, and has received top honors from: PC Photo, PC Magazine, PEI Magazine and American Photo. Canvas™ is presently the only commercially available cross-platform technical drawing program that seamlessly integrates professional-level image editing, advanced vector illustration, page layout, web graphics and presentation features into a single application.

ACD distributes its products through a network of distributors, value-added resellers ("VARs"), original equipment manufacturers ("OEMs"), direct-to-end users and by electronic sales download ("ESD") through our own website. ACD has operations in Canada, the United States, Japan and Switzerland and sells into other international markets through a variety of distributors, VARs and OEMs.

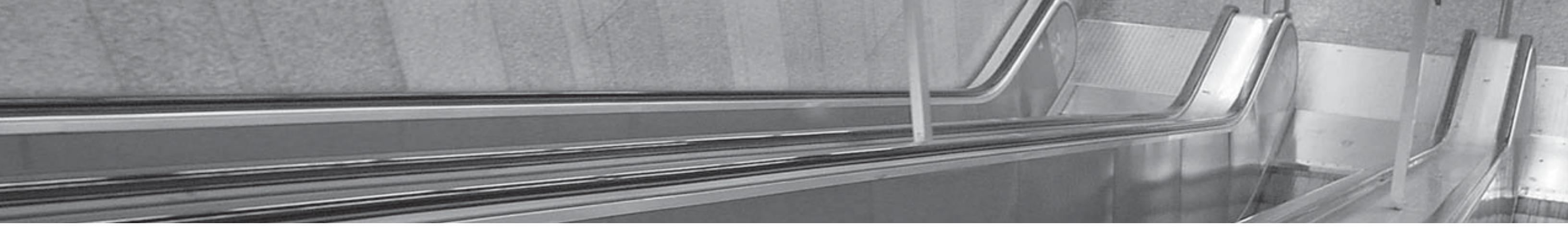
Results of Operations

Fiscal years ended March 31

(Canadian dollars in thousands)	2006		2005		2004	
	Actual	% of Sales	Actual	% of Sales	Actual	% of Sales
Sales	$ 18,154	100.0%	$ 23,872	100.0%	$ 25,417	100.0%
Cost of Sales	2,900	16.0%	3,651	15.3%	3,850	15.1%
Gross Margin	15,254	84.0%	20,221	84.7%	21,567	84.9%
Operating expenses:						
Sales, marketing and customer service	8,647	47.6%	8,178	34.3%	7,749	30.5%
Research and development	4,906	27.0%	5,971	25.0%	5,608	22.1%
General and administration	5,380	29.6%	5,180	21.7%	5,540	21.8%
Foreign currency (gains) and losses	444	2.4%	213	0.9%	(102)	(0.4%)
Amortization						
Equipment and leasehold improvements	393	2.2%	630	2.6%	751	3.0%
Intangible assets	1,812	10.0%	1,871	7.8%	2,343	9.2%
Operating expenses	21,582	118.9%	22,043	92.3%	21,889	86.1%
Operating income (loss)	(6,328)	(34.9%)	(1,822)	(7.6%)	(322)	(1.3%)
Goodwill impairment loss	(3,559)	(19.6%)	-	-	-	-
Interest income	407	2.2%	325	1.4%	464	1.8%
Other income (expenses)	215	1.2%	(314)	(1.3%)	(78)	(0.3%)
Earnings (loss) before income taxes	(9,265)	(51.0%)	(1,811)	(7.6%)	64	0.3%
Income taxes	357	2.0%	(1,596)	(6.7%)	(221)	(0.9%)
Net earnings (loss)	$ (9,622)	(53.0%)	$ (215)	(0.9%)	$ 285	1.1%
Basic and diluted earnings per share	$ (0.43)	-	$ (0.01)	-	$ 0.01	-

Consolidated sales have declined from $23.9 million in fiscal 2005 to $18.2 million in fiscal 2006. Digital imaging software sales decreased from $19.3 million in the prior year to $13.7 million for the twelve months ended March 31, 2006. Technical illustration software sales decreased from $4.6 million in fiscal 2005 to $4.5 million for the year ended March 31, 2006.

Net loss for the year ended March 31, 2006 was $9.6 million compared to a net loss of $0.2 million for the prior year. This net loss in the current period is due to a decrease in revenues in the digital imaging segment, an increase in operating expenses in the digital imaging software segment and in the corporate segment, as well as the recognition of an impairment loss for Goodwill. This was slightly offset by relatively stable revenues and a decrease in operating expenses in the technical illustration software segment. Basic and diluted loss per share was $0.43 for the current period compared to a loss per share of $0.01 in the last fiscal year.



Sales

Sales from the Company's two product segments were:

(Canadian dollars in thousands)	2006	2005	2004
Digital imaging software	$ 13,663	$ 19,302	$ 19,298
Technical illustration software	4,491	4,570	6,119
	$ 18,154	$ 23,872	$ 25,417

The majority of sales are derived from the Canadian operations, which develops and sells ACDSee™, with a significant portion of these coming directly from the Internet. The majority of ACDSee™ sales arise from selling the product as part of a bundle with either one or more of our own products or one or more third party plug-ins.

Digital imaging software sales decreased in fiscal 2006 to $13.7 million from $19.3 million in the prior year as a result of a decline in ESD, OEM and Distributor sales. ESD sales were diminished primarily because domain blocks were placed on ACDSee™ 8 post-launch email communications to customers as a result of integrity issues identified within the Company's customer email lists. A substantial portion of these domain blocks have been subsequently lifted as a result of cleaning up the integrity issues and adopting new industry best practices in managing these customer lists going forward. OEM sales declined due to the restructuring of an OEM contract and Distributor sales declined due to a five month delay in the release of ACDSee™ 7 in Japanese compared to the prior year. The Company's digital imaging software segment derives the majority of its revenues in US dollars and Euros. Both the US dollar and the Euro weakened compared to the prior year resulting in an approximate $1.5 million decrease in sales year to date. The weakening Euro, offset by increases in the US dollar during the current fourth quarter resulted in a decline of approximately $0.5 million compared to the prior year's fourth quarter.

Technical drawing software sales decreased from $4.6 million in the prior year period to $4.5 million in the current year. The Company derives the majority of its technical illustration software revenue in US dollars. The weakening US dollar resulted in a $0.4 million reduction in revenue year over year to date. As the US dollar strengthened during the fourth quarter, this resulted in a $0.1 million increase in revenues compared to the fourth quarter in the prior year.

The consolidated channel breakdown of sales for the current year is as follows: Direct – 14%; Reseller/Distributor – 29%; ESD – 43%; OEM – 10%, and Retail – 4%.

Non North American sales decreased from $14.9 million or 62% of total sales for the year ended March 31, 2005 to $10.7 million or 59% for the current year ended March 31, 2006.

Cost of Sales

Cost of sales includes product replication, freight, credit card transaction fees, royalties, bandwidth fees and fees paid to third party electronic sales providers. Cost of sales decreased to $2.9 million for the current year compared to $3.7 million in the prior fiscal year consistent with the decrease in revenues. Gross profit percentage decreased minimally from 85% in the year ended March 31, 2005 to 84% for the current year.

Sales, Marketing and Customer Service

Sales, marketing and customer service ("S&M") expense for the current year increased to $8.6 million from $8.2 million for the prior year ended March 31, 2005. S&M costs in the technical drawing segment decreased slightly from $1.92 million in the prior year to $1.86 million in the current year. S&M expense in the digital imaging software segment increased 8.5% from $6.3 million in the prior year to $6.8 million in the current year as a result of higher sub-contractor costs and advertising expenses. Selling costs continue to increase as the company rebuilds its sales and marketing teams. Subcontractor costs were incurred because high turnover resulted in certain key management positions being filled with contractors in the interim. Advertising costs were incurred as a result of efforts to maximize revenues in European distribution and ESD worldwide as well as a continuing effort to brand ACD. Additional costs were also incurred as a result of the Swiss and Seattle operations which did not exist in the prior year.

Research and Development

Research and Development ("R&D") expense decreased 18% from $6.0 million in the prior year to $4.9 million for the current year. R&D expense in the digital imaging software segment increased from $3.1 million in the prior year to $3.3 million in the current year due to higher localization and subcontract expenses. R&D expense in the technical drawing software segment has decreased from $2.8 million in the prior year to $1.6 million in the current year as a result of the April 2005 restructuring and increased staff turnover.

General and Administration

General and administration ("G&A") increased 4% from $5.2 million for the twelve months ended March 31, 2005 to $5.4 million for the current year. The increase in G&A expense in the current period is due to higher wages in the Corporate segment, incremental expenses related to the Seattle and Swiss operations, which did not exist in the prior year and higher subcontract expenses.

Foreign Currency (Gains) Losses

Foreign currency losses have increased from a loss of $0.2 million at March 31, 2005 to a loss of $0.4 million for the year ended March 31, 2006. Foreign currency (gains) losses are primarily generated as a result of the revaluation of foreign currency assets and liabilities at the balance sheet date. The majority of the Company's current assets held in foreign currencies are in US dollars and Euros.

Amortization

Amortization has decreased 12% from $2.5 million in the prior year to $2.2 million for the current year ended March 31, 2006 due to amortization being calculated on a declining balance basis.

Goodwill Impairment Loss

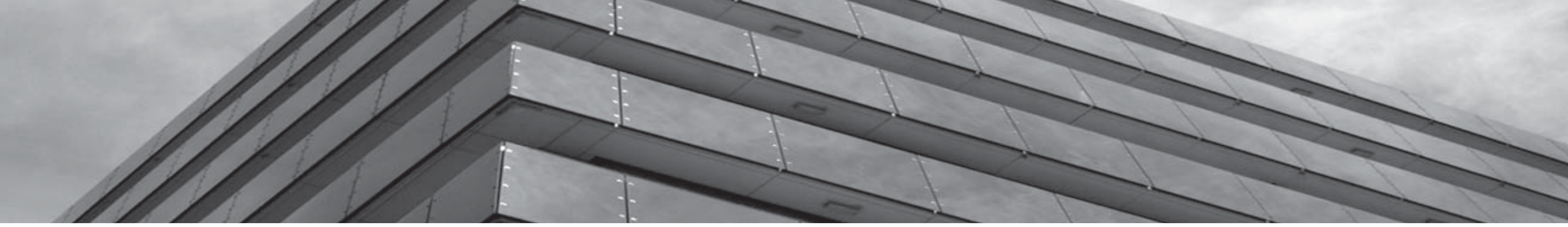
In the fourth quarter of 2006, the Company completed its annual goodwill impairment test. The technical illustration reporting unit has suffered from poor market conditions throughout 2006. As a result, the Company concluded that the fair value of goodwill for the technical illustration reporting unit was nil and recorded an impairment loss of $3.6 million.

Other Income and Expenses

Interest income increased by 25%, from $0.3 million at March 31, 2005 to $0.4 million at March 31, 2006 due primarily to an increase in interest rates. Other income is due to a $0.24 million recovery of previously accrued costs associated with the settlement of an underpayment of royalties in the US operations.

Income Taxes

The Company incurred tax expense of $0.4 million on pre-tax losses of $9.3 million for the year ended



March 31, 2006. The digital imaging software segment and Corporate segment have minimal current tax recoveries. The technical drawing software segment has a current tax expense of $0.09 million as a result of amendments made in the current period to prior year tax returns.

At December 31, 2005, the Company determined that criteria for full recognition of the benefit of tax losses incurred in the period may not be met at the end of the current fiscal year. Accordingly, future income tax assets were not recognized on tax losses incurred in the three month period ended December 31, 2005. An assessment of the realizability of future income tax assets was conducted at year end. As a result of this assessment, the valuation allowances for future income tax assets were increased from $3.0 million at March 31, 2005 to $4.9 million at March 31, 2006.

Net Earnings (Loss)

Net loss for the year ended March 31, 2006 was $9.6 million compared to a net loss of $0.2 million for the prior year ended March 31, 2005.

Basic and Diluted Earnings (Loss) per Share

Basic and diluted loss per share for the current twelve month period was $0.43 compared to basic and diluted loss per share of $0.01 in fiscal 2005. The loss per share for the current year was based on a basic and diluted weighted average number of shares of 22.3 million versus a basic and diluted weighted average number of shares of 23.7 million in the prior fiscal year.

ACD's working capital decreased from $19.9 million at March 31, 2005 to $13.3 million at March 31, 2006. Other than accounts payable, the Company has no debt.

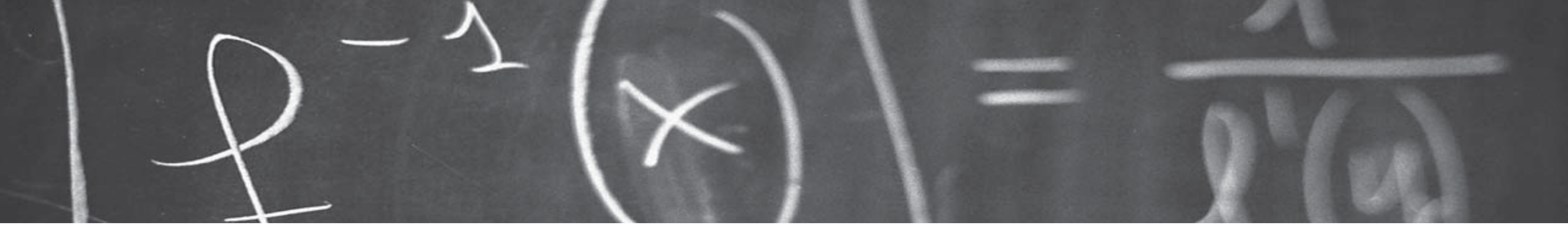
The Company's cash flow from operations decreased from an inflow of $3.5 million for the year ended March 31, 2005 to an outflow of $4.3 million for fiscal 2006.

The Company has issued and outstanding common shares totaling 21,060,343 at March 31, 2006 (March 31, 2005 – 23,382,057). The Company repurchased and cancelled 971,700 shares at an average price of $0.84 per share pursuant to a Normal Course Issuer Bid approved in August 2004 for a total of $0.81 million for the year ended March 31, 2006. The Company repurchased 1,254,856 shares at a price of $0.78 per share for a total of $0.98 million in the current year. The Company also recovered from escrow 95,158 shares at a price of $0.91 per share for a total of $0.09 million in the current year. The Company repurchased and cancelled 617,400 shares at an average price of $1.14 per share for a total reduction in share capital of $0.70 million in the prior year.

The contributed surplus balance of $2.0 million arose due to a change in accounting policy in fiscal 2005 for stock-based compensation. Of the $2.0 million balance, $0.8 million is due to an adjustment made in the first quarter of the prior year to opening retained earnings and contributed surplus to reflect the cumulative effect of the change on prior periods. Stock compensation expense recorded on the statement of operations since April 1, 2004 has resulted in $0.4 million of the increase in contributed surplus. The remaining $0.8 million increase is a result of shares repurchased and cancelled at a price lower than average carrying value.

Liquidity and Capital Resources

(Canadian dollars in thousands, audited)	As at March 31, 2006	As at March 31, 2005	% change from March 31, 2005
Working capital	$ 13,301	$ 19,914	(32.1%)
Cash and cash equivalents	12,707	19,133	(33.6%)
Net cash (used) provided by operating activities	(4,300)	3,512	(222.4%)



Financial Position

Cash and cash equivalents decreased to $12.7 million at March 31, 2006 from $19.1 million at March 31, 2005.

Accounts receivable have increased 11% to $2.2 million at March 31, 2006 from $2.0 million as at March 31, 2005. The increase is primarily due to sales of ACDSee™ 8, ACDSee™ Pro and Canvas™ X.

The income tax receivable balance of $0.1 million is due to current and prior year tax losses in the US operations, which can be applied against future earnings.

Inventory has decreased from $0.28 million at March 31, 2005 to $0.21 million at March 31, 2006. Inventory is valued at the lower of average cost and net realizable value, and is reviewed at the end of each month in order to identify slow moving or obsolete items. This decrease is primarily due to the write-off of obsolete inventory.

Future income tax assets have decreased from $5.4 million at March 31, 2005 to $4.2 million at March 31, 2006 due primarily to an increase in the valuation allowances related to the ACD Systems Ltd. (digital imaging segment) and ACD Systems International Inc. (corporate segment). Future income tax liabilities have decreased from $2.2 million at March 31, 2005 to $1.5 million at March 31, 2006 due to the drawdown of the liability set up on the intangible assets purchased in the Deneba acquisition.

The $3.7 million in intangible assets that arose primarily on the merger with Deneba have decreased from $5.5 million at March 31, 2005 as they are being amortized over their estimated useful lives. This represents various intangibles such as employee contracts, domain names, customer relationships and technology. These intangibles are being amortized over periods varying from three months to five years.

Goodwill of $3.6 million on the March 31, 2005 balance sheet also arose in the merger with Deneba. In accordance with GAAP, goodwill is not amortized. It is tested at least annually for impairment and written down at that time if deemed necessary. In the fourth quarter of 2006, the Company completed its annual goodwill impairment test. The technical illustration reporting unit has suffered from poor market conditions throughout 2006. As a result, the Company concluded that the fair value of goodwill for the technical illustration reporting unit was nil and recorded an impairment loss of $3,559,162.

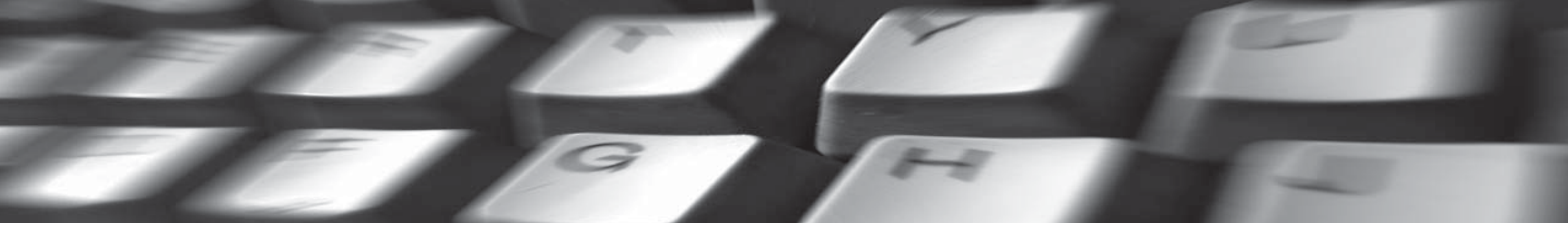
Accounts payable and accrued liabilities have decreased to $2.1 million for the year ended March 31, 2006 compared to $2.9 million at the end of fiscal 2005. This is primarily due to the reduction of balances accrued at March 31, 2006 for unpaid royalties, severance, vacation and benefits.

Deferred revenue has decreased to $0.64 million from $0.84 million due to a reduction of deferrals made at March 31, 2006 for royalties, post contract support, maintenance contracts and product upgrades.

The deferred income tax credit is a result of the Linmor purchase. The fair value of the future tax assets purchased exceeded the total purchase consideration and has been recorded as a deferred credit that will reduce current income tax expense in proportion to the utilization of the related future income tax asset. The deferred credit is not being amortized because the Company has a loss for tax purposes for the year ended March 31, 2006.

The Company has entered into agreements related to operating leases for premises. The following table lists the Company's contractual obligations for these lease commitments as of March 31, 2006:

(Canadian dollars in thousands)	Total	FY 2007	FY 2008	FY 2009	Thereafter
Operating leases	$ 1,317	$ 726	$ 331	$ 167	$ 93



Selected Historical Consolidated Financial Data

The selected consolidated financial data as of and for the three months ending June 30, 2004 through March 31, 2006 are derived from our unaudited interim consolidated financial statements. Historical results are not necessarily indicative of the financial position or results that may be expected for any future period, or for a full year. The financial information contained in the table below has been prepared in accordance with Canadian GAAP. Please read the selected historical consolidated financial information set forth below together with our historical consolidated financial statements and the related notes, together with this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Selected Consolidated Statements of Income Data (unaudited)

(Canadian dollars in thousands, except per share data)

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006
Sales	$5,540	$4,728	$8,445	$5,159	$4,098	$4,472	$4,855	$4,729
Net earnings (loss)	402	(1,390)	1,795	(1,022)	(921)	(1,855)	(1,260)	(5,586)
Basic and diluted earnings (loss) per share	0.02	(0.06)	0.08	(0.04)	(0.04)	(0.08)	(0.06)	(0.43)

The Company's quarterly sales trend year over year is relatively consistent with the third quarter historically being the strongest due to the timing of product launches.

Sales in Q1 2006 were significantly lower than Q1 2005 due to timing of localized product launches in the digital imaging software segment. ACDSee™ 6 Japanese was launched in April 2004, while ACDSee™ 7 Japanese launched in September 2005. The retail launch of ACDSee™ 6 German was in February of 2004 while the retail launch of ACDSee™ 7 German was in October 2004.

ACD sales in Q2 2005 were higher than Q2 2006 due to the delay in email communications to customers related to the launch of ACDSee™ 8 in the current year and the delay of launching ACDSee™ 7 in Asia until late September 2005. In addition, an additional allowance was set up in Q2 2006 for returns of Canvas™ 9 Japanese in anticipation of the release of Canvas™ X Japanese in October.

Sales for Q3 2006 were significantly lower than in Q3 2005 and inconsistent with historical trends due primarily to low ESD sales. Integrity issues with email communications to customers resulted in domain blocks being placed on these email communications which translated into significantly lower sales for Q3 2006. In addition, a decrease in OEM partner revenues due to the renegotiation of a major contract also contributed towards lower sales.

Sales for Q4 2006 were significantly lower than Q4 2005 due to a failure to generate new customers and changing market conditions. This shortfall occurred despite the launch of ACDSee™ Pro January 2006.

Critical Accounting Policies and Estimates

The Company's consolidated financial statements are prepared in accordance with Canadian GAAP. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the reported amounts of revenues and expenses during the reported period. The Company regularly evaluates its estimates and assumptions based on historical experience and other relevant factors. Under different assumptions or conditions, the actual results could differ materially from these estimates and assumptions. The significant accounting policies and methods used are described in Note 1 of the annual audited Canadian GAAP

financial statements included in the 2006 Annual Report. The following critical accounting policies affect the more significant estimates and assumptions used in preparing the March 31, 2006 audited annual financial statements.

Revenue

The Company derives all of its revenues from licenses of software products and related services. Revenue is recognized in accordance with Statement of Position ("SOP") 97-2 Software Revenue Recognition issued by the American Institute of Certified Public Accountants. Product license revenue is recognized under SOP 97-2 when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable and supported and the arrangement does not require services that are essential to the functionality of the software.

Persuasive evidence of an arrangement exists – The Company determines that persuasive evidence of an arrangement exists when a contract has been signed by both the Company and the customer. In the absence of a contract, a purchase order or quote received from and signed by the customer will suffice as persuasive evidence.

Delivery has occurred – The Company's software may be either physically or electronically delivered to the customer. The Company determines that delivery has occurred upon shipment of the software pursuant to the billing terms of the arrangement or when the software is made available to the customer through electronic delivery.

The fee is fixed or determinable – The Company typically sells its software for a fixed price. If the fee is not fixed or determinable revenue is typically recognized when the fee becomes due and payable.

Collectibility is probable and supported – The Company determines collectibility on a case-by-case basis. The Company assesses the probability of collection from customers based on history if applicable, and a credit review process, which evaluates the customer's financial position and ultimately their ability to pay. If the Company is unable to determine that collectibility is probable, revenue is recognized as payments are received.

Customer deposits and billed amounts due from customers in advance of the recognition of revenue are recorded as deferred revenue.

Allowance for Doubtful Accounts

The Company records an allowance for doubtful accounts related to accounts receivable that are considered to be impaired reflecting the inability of our customers to make required payments. This allowance is based on the Company's knowledge of the financial condition of its customers, the aging of the receivables, the current business environment and historical experience. A change in one or more of these factors could impact the estimated allowance and provision for bad debts recorded.

Inventory Reserves

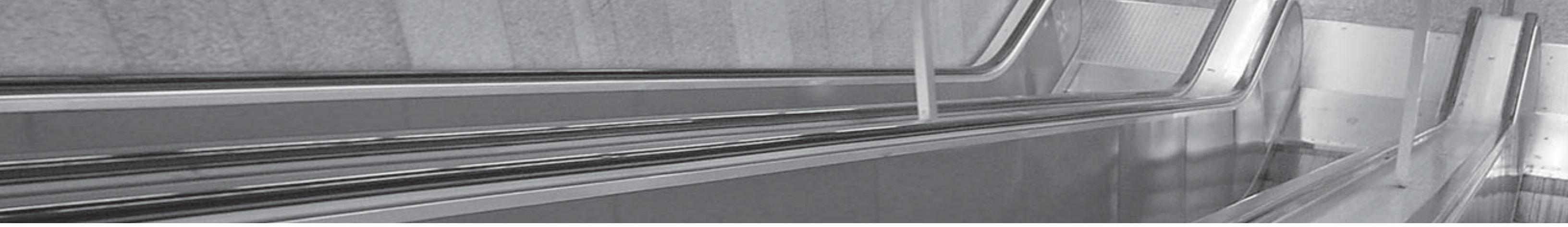
The Company evaluates inventory balances on a monthly basis and records a provision as necessary for slow moving or obsolete inventory.

Income Taxes

The Company records a valuation allowance against future income tax assets when management believes it is more likely than not that some portion or all of the future income tax assets will not be realized. Management considers factors such as the projected taxable income, the character of the income tax asset and tax planning strategies. A change to these factors could impact the estimated valuation allowance and income tax expense.

Intangible Assets

The Company is required to value any intangible assets acquired at the date of acquisition as part of the completion of any business combination. This valuation is inherently subjective, and necessarily involves judgments and estimates regarding future cash flows and other operational variables of the



entity acquired. However, there can be no assurance that the judgments and estimates made will reflect future performance of the acquired entity. If management makes judgments or estimates that differ from actual circumstances, the Company may be required to write-off certain of its intangible assets.

Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the identifiable assets acquired, less liabilities assumed, based on their fair values. Goodwill recorded on acquisition is not amortized, but is instead subject to the annual impairment test of all recorded goodwill. The test is performed annually, and more frequently if events or changes in circumstances indicate that goodwill may be impaired. Goodwill is tested for impairment at a level of reporting referred to as a reporting unit. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. If the carrying value exceeds the fair value, the second step would be performed, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount. When the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized. On March 31, 2006, the Company performed its annual impairment test and determined that an impairment of the recorded goodwill had occurred. See the discussion elsewhere in this MD&A.

New Accounting Policies

There were no changes in Canadian GAAP accounting policies for the quarter ended March 31, 2006.

Off Balance Sheet Arrangements

The Company has no off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Related Party Transactions

The Company has not engaged in any material related party transactions. Current related party transactions include ongoing consulting contracts to assist the Company with potential acquisitions.

Disclosure Controls

As at March 31, 2006, the Company reviewed, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of its disclosure controls and procedures. There are limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and of individuals overriding the controls and procedures. As a result, even effective disclosure controls and procedures can fail to achieve the desired results. Based upon our evaluation and as of March 31, 2006, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures provide the Company with reasonable assurances that the information required to be disclosed in the Company's reports that are filed and submitted to the securities regulatory authorities are recorded, processed, summarized and reported as and when required.

Outlooks, Risks and Uncertainties That Could Affect Future Results

Past performance is not a guarantee of future performance. From time to time, certain information provided by the Company or its employees may involve risks and uncertainties, specifically, any statements relating to the Company's expectations for the future sales of its products. Factors that may cause such differences include, but are not limited to, the factors discussed below. These factors, and others, are discussed from time to time in the Company's filings with the securities regulatory authorities. Although management remains optimistic about the Company's long-term prospects, the Company's future results are subject to substantial risks and uncertainties.

Competition

The market for the software and products supplied by the Company is highly competitive and subject to rapid change. Many of the Company's current and potential competitors have larger technical staff, more established and larger sales and marketing organizations and significantly greater financial resources. Additionally, there can be no assurance that competitors will not develop products that are superior to the Company's products or that achieve greater market acceptance due to pricing, access to distributors or other factors. Pricing is an important element of competition and is regularly reviewed by the Company in response to changes in market conditions. There can be no assurance that the Company's pricing strategy will be successful or that any price changes will not have an adverse effect on the Company's gross margins.

Potential Acquisitions and Investments

The Company expects to continue to acquire or invest in businesses, products and technologies that expand or complement the Company's current business or products. Such acquisitions or investments may involve significant commitments of financial or other resources of the Company. There can be no assurance that any such acquisitions or investments will generate revenue, income or other returns for the Company, or that financial or other resources committed to such activities will not be lost. Such activities could also place additional strains on the Company's administrative and operational resources and its ability to manage growth.

Management of Growth and Integration of Acquisitions

The Company believes that continued growth of its product lines and number of personnel is required to maintain its competitive position. The Company has grown both organically and by acquisition in the past and expects to continue to do so in the future. There can be no assurances that the Company will complete any future acquisitions and, if completed, such acquisitions will be successfully integrated into the Company. If the Company is unable to manage growth effectively, the Company's business, operating results and financial condition may be adversely affected.

Volatility of Share Price

The Common Shares currently trade on the TSX. The market price of the Company's common shares can be highly volatile and subject to fluctuations. These fluctuations in market price may continue due to quarterly variations in operating results, announcements of new products or technological innovations by the Company or its competitors, changes in financial estimates by securities analysts or other events or factors. In addition, the financial markets have experienced significant price fluctuations that have particularly affected the market price of equity securities of many high technology companies, and which often have been unrelated to the operating performance of such companies. These market fluctuations may materially and adversely affect the market price of the Common Shares.

Foreign Currency Risk

The Company operates internationally and, accordingly, a portion of our financial resources is held in currencies other than the Canadian dollar, the functional currency of the Company. Further to this, the Company generates revenues and incurs expenses in numerous currencies. The Company's exposure to various currencies may change over time as the geographic mix of our worldwide business changes. These currencies could be unfavorably impacted by global developments, country specific events and many other factors. Consequently, the Company's future results could be adversely affected by significant foreign exchange fluctuations. The Company has entered into limited forward exchange contracts or options to mitigate the exchange risk.

Potential Fluctuations in Financial Results

The Company considers fluctuations in its quarterly earnings to have an impact on its future financial position. The Company's expense levels are based in part on its expectations for future orders and sales, and the Company may not be able to adjust spending in a timely manner to compensate for any sales shortfalls.

Proprietary Technology

The Company's success will depend, in part, on its ability to maintain copyright and trademark protection, trade secret protection and operate without infringing the proprietary rights of third parties. The Company relies principally on trade secret and trademark law, as well as confidentiality procedures, nondisclosure agreements and other contractual arrangements, to protect its proprietary technology. There can be no assurance that the Company's intellectual property rights, copyright and/or trademarks will not be challenged by any third parties, or that the intellectual property rights of others will not have a material adverse effect on the ability of the Company to do business. Furthermore, there can be no assurance that others will not independently develop products similar to those developed by the Company or duplicate any of the Company's products. The Company operates in an international environment with approximately 59% of its revenue derived from countries outside of North America. Although the Company makes every effort to protect its intellectual property rights, there can be no guarantee that unlicensed copying of the Company's software will not take place, especially in countries where software piracy laws and enforcement are weak. In addition, the Company could incur substantial time, effort and/or costs in policing unauthorized use of its intellectual property and/or in defending itself in suits brought against it or in suits in which the Company attempts to enforce its own intellectual property rights against other parties.

Dependence on Key Personnel

The Company's business is dependent upon its ability to retain and attract highly skilled persons. Competition for qualified personnel is considerable and the Company's future success will depend in large part on its continuing ability to attract and retain qualified employees. The Company's business is also dependent on the expertise provided by its Chief Executive Officer and other members of its management team. ACD maintains an attractive employee benefits plan, including stock options and profit sharing in order to minimize the likelihood of key employee departure.

Liquidity and Capital Needs

The Company's future capital requirements will depend on many factors, including its product development programs. In order to meet such capital requirements, the Company will consider additional public or private financings (including the issuance of additional equity securities) to fund all or part of its requirements. There can be no assurance that additional funding will be available or, if available, that it will be available on acceptable terms. If adequate funds are not available, the Company may have to substantially reduce or eliminate expenditures for marketing, research and development and testing of its proposed products, or obtain funds through arrangements with partners that require the Company to relinquish rights to certain of its technologies or products. There can be no assurance that the Company will be able to raise additional capital if its capital resources are exhausted.

Technological Change

The Company's ability to continue to develop and introduce products or enhancements of existing products may require significant additional research and development expenditures. The Company's future success in these areas will depend substantially on its ability to develop new or enhanced products which achieve market acceptance. Technology continues to advance at a rapid pace which requires the timely introduction of new products and technologies. Management has no knowledge that there are existing or upcoming technologies which would make obsolete or significantly displace the technologies utilized by the Company. However, such a risk exists and, if it materializes, would have an adverse impact on the future growth of the Company.

Third Party Agreements

The Company has entered into, and intends to continue to enter into, relationships with OEMs of both hardware and software for the distribution of our products. While contracts include specific provisions protecting the Company from third party claims, OEMs and similar distributors are not, and will not be, within the Company's control. Although the Company makes every effort to protect itself from such claims, there can be no guarantee that such claims will not occur. In addition, the Company could incur substantial time, effort and/or costs in defending itself in suits brought against it.

ACD Systems International Inc.

Consolidated Financial Statements
of Years ended March 31, 2006 and 2005

Auditors' Report to the shareholders

We have audited the consolidated balance sheets of ACD Systems International Inc. as at March 31, 2006 and 2005 and the consolidated statements of operations and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

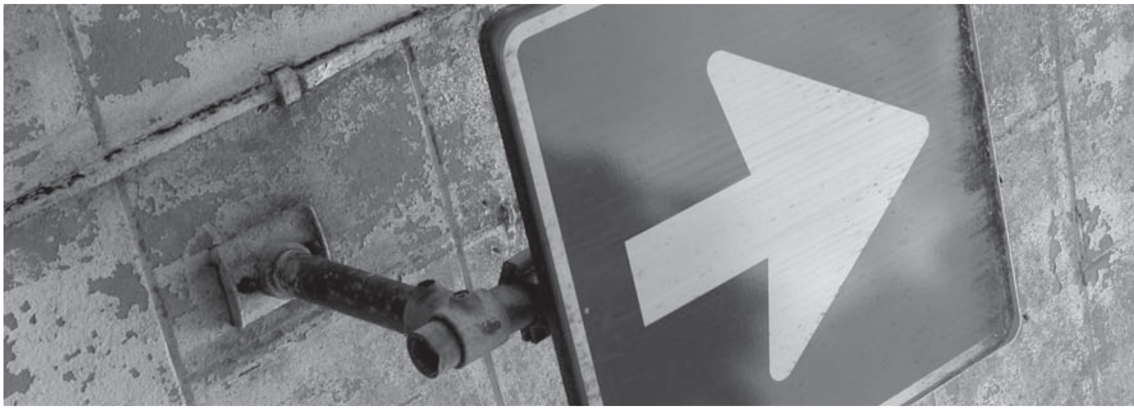
In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Victoria, Canada

May 26, 2006



ACD Systems International Inc.

Consolidated Balance Sheets (Expressed in Canadian Dollars)
March 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	$ 12,706,697	$ 19,133,375
Accounts receivable	2,234,406	2,011,003
Foreign currency derivatives (note 2(b))	-	28,900
Prepaids and deposits	462,939	594,116
Income tax receivable	100,690	335,000
Inventory	208,487	277,152
Future income taxes (note 3)	1,012,600	1,986,786
	16,725,819	24,366,332
Investment tax credits	371,175	157,911
Equipment and leasehold improvements (note 4)	934,845	1,138,047
Intangible assets (note 5)	3,692,462	5,451,556
Goodwill (note 6)	-	3,559,162
Future income taxes (note 3)	3,207,434	3,386,613
	$ 24,931,735	$ 38,059,621
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 2,100,655	$ 2,923,317
Deferred revenue	635,877	837,344
Future income taxes (note 3)	688,272	691,237
	3,424,804	4,451,898
Future income taxes (note 3)	802,725	1,475,549
Deferred income tax credit (note 7)	2,511,800	2,511,800
Shareholders' equity:		
Share capital (note 8)	24,724,385	27,485,865
Contributed surplus (note 8(d))	2,020,892	1,063,296
Retained earnings (deficit)	(8,552,871)	1,071,213
	18,192,406	29,620,374
Contingent liabilities (note 10)		
Commitments (note 12)		
	$ 24,931,735	$ 38,059,621

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Director Douglas Vandekerkhove

Director Inder Duggal

ACD Systems International Inc.

Consolidated Statements of Operations and Retained Earnings (Deficit)
(Expressed in Canadian Dollars)
Years ended March 31, 2006 and 2005

	2006	2005
Sales (note 13)	$ 18,153,978	$ 23,871,896
Cost of sales	2,899,871	3,651,312
Gross profit	15,254,107	20,220,584
Operating expenses:		
Sales, marketing and customer service	8,647,000	8,178,279
Research and development	4,906,071	5,970,831
General and administration	5,380,382	5,179,884
Foreign currency losses	443,813	213,400
Amortization:		
Equipment and leasehold improvements	393,418	630,060
Intangible assets	1,811,620	1,870,315
	21,582,304	22,042,769
Operating loss	(6,328,197)	(1,822,185)
Other income (expense):		
Goodwill impairment loss (note 6)	(3,559,162)	-
Interest income	407,047	325,480
Other (note 9)	215,401	(314,228)
	(2,936,714)	11,252
Loss before income taxes	(9,264,911)	(1,810,933)
Income taxes (recovery) (notes 3 and 7):		
Current	92,995	(1,159,386)
Future	264,313	(436,589)
	357,308	(1,595,975)
Net loss	(9,622,219)	(214,958)
Retained earnings, beginning of year	1,071,213	1,340,560
Share redemptions in excess of assigned value (note 8(b))	(1,865)	(54,389)
Retained earnings (deficit), end of year	$ (8,552,871)	$ 1,071,213
Loss per share:		
Basic and diluted	$ (0.43)	$ (0.01)
Weighted average number of shares outstanding (note 11):		
Basic and diluted	22,268,324	23,665,555

See accompanying notes to consolidated financial statements.

ACD Systems International Inc.

Consolidated Statements of Cash Flows (Expressed in Canadian Dollars)
Years ended March 31, 2006 and 2005

	2006	2005
Cash provided by (used in):		
Operations:		
Net loss	$ (9,622,219)	$ (214,958)
Items not involving cash:		
Future income taxes	264,313	(436,589)
Goodwill impairment loss	3,559,162	-
Stock-based compensation	78,299	296,044
Forward currency derivatives	28,900	(28,900)
Amortization:		
Equipment and leasehold improvements	393,418	630,060
Intangible assets	1,811,620	1,870,315
Deferred income tax credit	-	(859,705)
Changes in non-cash operating working capital:		
Accounts receivable	(223,403)	1,090,935
Income tax receivable	234,310	(335,000)
Prepaids and deposits	131,177	(13,023)
Inventory	68,665	267,252
Accounts payable and accrued liabilities	(822,662)	1,136,919
Taxes payable	-	(28,374)
Deferred revenue	(201,467)	137,574
	(4,299,887)	3,512,550
Investing:		
Additions to equipment and leasehold improvements	(190,216)	(295,317)
Additions to patents and trademarks	(52,526)	(26,623)
	(242,742)	(321,940)
Financing:		
Proceeds from shares issued	-	47,506
Shares repurchased	(1,876,041)	(759,044)
Share issue and repurchase costs	(8,008)	(7,497)
	$ (1,884,049)	(719,035)
Increase (decrease) in cash and cash equivalents	(6,426,678)	2,471,575
Cash and cash equivalents, beginning of year	19,133,375	16,661,800
Cash and cash equivalents, end of year	$ 12,706,697	$ 19,133,375
Supplemental cash flow information:		
Cash during the year for:		
Income taxes paid	$ -	$ 68,863
Interest paid	2,155	46,547

See accompanying notes to consolidated financial statements.

ACD Systems International Inc. (the "Company") designs, develops, markets and supports digital imaging software, technical drawing software and other related products.

1. Significant accounting policies:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The following is a summary of the significant accounting policies used in the preparation of the consolidated financial statements. Material measurement differences between these principles and accounting principles generally accepted in the United States of America are disclosed in note 14.

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries: ACD Systems Ltd.; ACD Systems of America, Inc.; ACD Systems Inc. and ACD Systems (Switzerland) GmbH. All inter-company balances and transactions have been eliminated.

(b) Cash and cash equivalents:

Cash and cash equivalents are defined as cash and highly liquid investments, consisting primarily of term deposits, with terms to maturity of three months or less at the date of purchase.

(c) Revenue recognition:

The Company recognizes revenue as described below which is consistent with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2") issued by the American Institute of Certified Public Accountants.

The Company recognizes revenue from packaged software and license fees when the software is delivered, title has passed and customer acceptance has occurred, there is persuasive evidence that an arrangement exists, the fee is fixed and determinable, and collection is probable.

Post contract customer support ("PCS") revenue, including software maintenance and telephone support, is recognized upon delivery of the software if the fee for the PCS is included in the initial licensing fee, the PCS term is for one year or less, the estimated cost of providing the PCS is insignificant and unspecified upgrades or enhancements are historically and expected to be minimal and infrequent. The Company's PCS revenue meets the criteria noted above and is recognized upon delivery of the software. All estimated costs of providing the PCS services are accrued at that time.

Revenue from sale of customized software is recognized using the percentage-of-completion method based on the work plan and milestones achieved.

Payments received in advance of the satisfaction of the Company's revenue recognition policies are recorded as deferred revenue.

(d) Inventories:

Inventories consist of finished goods and are stated at the lower of average cost and net realizable value. Inventories are recorded net of any obsolescence provisions.

1. Significant accounting policies (continued):

(e) Equipment and leasehold improvements:

Equipment and leasehold improvements are recorded at cost less any tax credits received, or receivable when reasonable assurance as to collection exists, and are amortized at rates which will reduce original cost to estimated residual value over the useful life of each asset. Amortization is provided using the following basis and annual rates:

Asset	Basis	Rate
Computer hardware	Declining balance	30%
Application software	Declining balance	100%
Office equipment	Declining balance	20%
Tradeshow equipment	Declining balance	30%

Leasehold improvements are amortized on a straight-line basis over the term of the lease.

(f) Intangible assets:

Intangible assets with definitive useful lives are amortized over their useful lives, which vary from three months to five years.

(g) Goodwill:

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the identifiable assets acquired less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company's reporting units that are expected to benefit from the synergies of the business combination.

Goodwill is not amortized and is tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of goodwill is determined in a business combination described in the preceding paragraph, using the fair value of the reporting unit as if it was the purchase price. When the carrying amount of reporting unit goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess and is presented as a separate line item in the consolidated statements of operations and retained earnings (deficit) before extraordinary items and discontinued operations.

1. Significant accounting policies (continued):

(h) Foreign currency translation:

The reporting and measurement currency of the Company and its subsidiary, ACD Systems Ltd., is the Canadian dollar.

The operations of the Company's wholly owned foreign subsidiaries, ACD Systems Inc., ACD Systems of America, Inc. and ACD Systems (Switzerland) GmbH, are considered to be fully integrated with those of the parent. As such, for financial statement presentation purposes, foreign currency denominated amounts are translated into Canadian dollars as follows:

(i) Monetary assets and liabilities are translated at the rate of exchange at the balance sheet date;

(ii) Other assets and liabilities are translated at historical rates; and

(iii) Revenue and expenses are translated at the rate of exchange in effect on the dates on which such transactions occur.

Exchange gains and losses are included in the determination of income.

(i) Derivative financial instruments:

The Company uses certain derivative financial instruments, principally forward foreign exchange contracts, to manage foreign currency exposures on export sales. Derivative financial instruments are used for risk management purposes and not for generating trading profits. Derivative financial instruments are not accounted for as hedges. The realized and unrealized gains and losses are recognized in the operating income of the Company. Fair values are determined using current market rates for the settlement of the derivative instruments.

(j) Earnings (loss) per share:

The Company calculates earnings (loss) per share using the weighted average number of common shares outstanding during the period excluding escrowed shares the release of which are subject to the satisfaction of performance criteria. Diluted earnings (loss) per share are calculated by the treasury stock method. Under the treasury stock method, the weighted average number of common shares outstanding assumes that proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period in calculating the net dilution impact. Stock options and warrants are dilutive when the Company has income from continuing operations and the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

(k) Stock-based compensation:

The Company has a stock-based compensation plan which is described in note 8(c). The Company accounts for all stock-based payments and awards under the fair value based method. Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date.

1. Significant accounting policies (continued):

   (k) Stock-based compensation (continued):

   Under the fair value based method, compensation cost attributable to awards to employees is measured at fair value at the grant date and recognized over the vesting period. Compensation cost attributable to awards to employees that call for settlement in cash or other assets is measured at intrinsic value and recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. Compensation cost is generally recognized on a straight-line basis over the vesting period. The Company accounts for the fair value of the granted options on the consolidated statements of operations and retained earnings (deficit) and is included in the determination of income.

   In fiscal 2005, the Company retroactively applied the fair value based method to all employee stock options granted on or after April 1, 2002, with no prior period restatement.

   (l) Future income taxes:

   The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statements' carrying amounts of existing assets and liabilities and their respective tax bases and loss carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable earnings in the year in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the date of substantive enactment. To the extent that it is not more likely than not that a future tax asset will be realized, a valuation allowance is provided.

   (m) Asset retirement obligations:

   The Company recognizes a liability at its fair value for any legal obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is required to be added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

   (n) Measurement uncertainty:

   The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Significant areas requiring the use of significant judgment include the measurement of deferred revenue related to future services, return provisions, amortization periods of intangible assets, valuation of stock compensation, recoverability of tax credits, and the estimation of future income tax asset valuation allowances. Actual results could differ from these estimates.

1. Significant accounting policies (continued):

(o) Impairment of long-lived assets:

The Company monitors the recoverability of long-lived assets, including equipment and leasehold improvements and intangible assets, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company reviews factors such as current market value, future asset utilization and business climate and, when such indicators exist, compares the carrying value of the assets to the future undiscounted cash flows expected to result from the use of the related asset. If such cash flows are less than the carrying value, the impairment charge to be recognized equals the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is generally measured equal to the estimated future discounted net cash flows from the asset or assets.

(p) Comparative figures:

Certain 2005 comparative figures have been reclassified to conform with the financial statement presentation adopted for the current year.

2. Financial instruments:

(a) Fair value:

For certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities, the carrying amounts approximate fair value due to their immediate or short-term maturity.

(b) Currency risk:

The Company undertakes revenue and purchase transactions in foreign currencies and therefore is subject to gains and losses due to fluctuations in foreign exchange rates. The Company periodically enters into forward foreign exchange contracts and options to manage its foreign currency exposure. The contracts oblige the Company to sell U.S. dollars and Euros in the future at predetermined exchange rates. The contracts are matched with anticipated future sales in foreign currencies. At March 31, 2005, the Company had purchased an option to sell U.S. $1,000,000 in the next 12 months at an average exchange rate of $1.2385.

The option had a fair value of $28,900 which has been recorded as a foreign currency derivative on the balance sheet at March 31, 2005. This gain was realized in the current year. No forward exchange contracts or options were held at March 31, 2006.

(c) Concentrations of credit risk:

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents and trade accounts receivable. To reduce credit risk, cash equivalents are only held at major financial institutions and management performs ongoing credit evaluations of its customers' financial condition. The Company maintains reserves for potential credit losses.

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

3. Future income taxes:

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at March 31, 2006 and 2005 are presented below:

	2006	2005
Current portion of future tax assets:		
Loss carryforwards	$ 951,846	$ 1,781,000
Reserves	58,313	203,215
Share issue costs	2,441	2,571
	1,012,600	1,986,786
Long-term portion of future tax assets:		
Loss carryforwards	7,863,075	6,101,932
Equipment	250,614	256,725
Share issue costs	3,968	4,436
	8,117,657	6,363,093
Less valuation allowance	(4,910,223)	(2,976,480)
	3,207,434	3,386,613
	$ 4,220,034	$ 5,373,399
Current portion of future tax liabilities:		
Intangibles	$ 688,272	$ 691,237
Long-term portion of future tax liabilities:		
Intangibles	802,725	1,475,549
	$ 1,490,997	$ 2,166,786

The net future tax asset is calculated at a rate of 34.12% (2005 - 35.62%) to reflect substantively enacted tax rate changes for federal and provincial taxes, based on estimates of when temporary differences will reverse.

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

3. Future income taxes (continued):

The Company's provision for income taxes is comprised of:

	2006	2005
Provision (recovery) for income taxes based on combined basic Canadian federal and provincial income tax rate of 34.12% (2005 - 35.62%)	$ (3,284,020)	$ (645,054)
Increase (decrease) in taxes resulting from:		
Net tax effect of expenses not deductible for income tax purposes	1,258,868	299,825
Change in future tax rates	141,684	-
Change in valuation allowance and tax credits not previously recognized	2,166,875	(439,654)
Deferred tax credit amortization	-	(859,705)
Amendment of prior year tax returns	94,605	-
Other	(20,704)	48,613
	$ 357,308	$ (1,595,975)

As at March 31, 2006, the Company has non-capital loss carryforwards of $16,910,966 available to reduce taxable income otherwise calculated in future years. These losses, unless applied, will expire as follows:

2007	$ 552,252
2008	5,898,000
2009	5,676,340
2010	2,069,221
2011	-
Thereafter	2,715,153
	$ 16,910,966

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

4. Equipment and leasehold improvements:

2006	Cost	Accumulated amortization	Net book value
Computer hardware	$ 2,709,891	$ 2,049,220	$ 660,671
Application software	2,182,581	2,173,557	9,024
Office equipment	609,447	400,656	208,791
Tradeshow equipment	18,220	12,917	5,303
Leasehold improvements	167,891	116,835	51,056
	$ 5,688,030	$ 4,753,185	$ 934,845

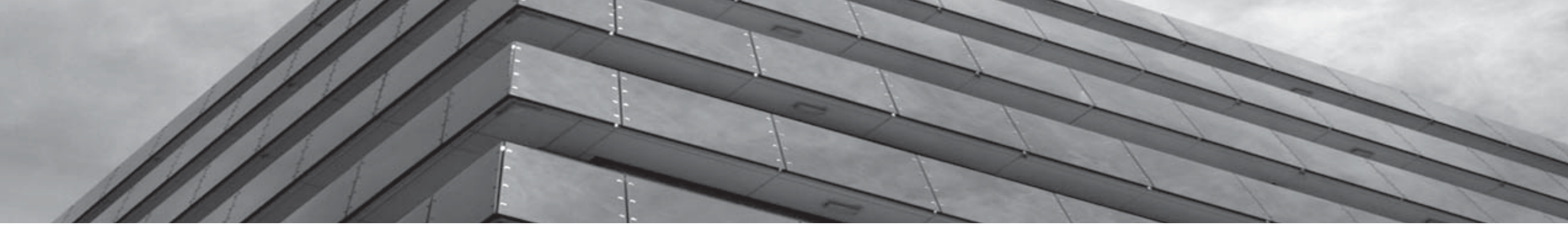
2005	Cost	Accumulated amortization	Net book value
Computer hardware	$ 2,569,277	$ 1,837,878	$ 731,399
Application software	2,164,509	2,116,824	47,685
Office equipment	582,321	349,043	233,278
Tradeshow equipment	179,648	138,597	41,051
Leasehold improvements	167,891	83,257	84,634
	$ 5,663,646	$ 4,525,599	$ 1,138,047

5. Intangible assets:

2006	Cost	Accumulated amortization	Net book value
Licensed technology	$ 7,708,500	$ 4,496,624	$ 3,211,876
Other intangible assets	1,763,550	1,353,627	409,923
Patents and trademarks	370,139	299,476	70,663
	$ 9,842,189	$ 6,149,727	$ 3,692,462

2005	Cost	Accumulated amortization	Net book value
Licensed technology	$ 7,708,500	$ 2,954,924	$ 4,753,576
Other intangible assets	1,763,550	1,142,455	621,095
Patents and trademarks	317,613	240,728	76,885
	$ 9,789,663	$ 4,338,107	$ 5,451,556

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)



6. Goodwill:

In the fourth quarter of 2006, the Company completed its annual goodwill impairment test. The technical illustration reporting unit, to which all recorded goodwill related, has suffered operating losses and negative quarterly cash flows from poor market conditions throughout 2005 and 2006. As a result, the Company concluded the fair value of this reporting unit was less than its carrying value and that the fair value of goodwill for the technical illustration reporting unit was nil and recorded an impairment loss of $3,559,162.

7. Deferred income tax credit:

Balance, March 31, 2004	$ 3,371,505
Amortization	(859,705)
Balance, March 31, 2005 and 2006	$ 2,511,800

The amortization of the deferred income tax credit balance has been applied against current tax expense.

8. Share capital:

The share capital of the Company is as follows:

(a) Authorized:

Unlimited number of common shares
Unlimited number of preferred shares

(b) Issued:

	Common shares	Average price per share	Amount
March 31, 2004	23,826,707		$ 28,150,511
Options exercised	172,750	0.28	47,506
Shares repurchased and cancelled	(617,400)	1.14	(704,655)
	23,382,057		27,493,362
Less issue and repurchase costs	-		(7,497)
March 31, 2005	23,382,057		27,485,865
Shares repurchased and cancelled	(2,226,556)	1.19	(2,640,624)
Share recovery (note 9)	(95,158)	1.19	(112,848)
	21,060,343		24,732,393
Less repurchase costs	-		(8,008)
March 31, 2006	21,060,343		$ 24,724,385

The repurchase and cancellation of shares resulted in a $1,865 (2005 - $54,389) charge to retained earnings for shares repurchased and cancelled at a price higher than average carrying value and a $879,297 (2005 - nil) increase to contributed surplus for shares repurchased and cancelled at a price lower than average carrying value.

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

8. Share capital (continued):

(c) Share purchase options:

Options to purchase common shares of the Company may be granted by the Board of Directors to employees, directors, officers and other service providers. A total of 4,668,630 options have been authorized and the vesting period is generally four years. These options expire five years from the date granted. A summary of the status of the options outstanding as of March 31, 2006 and 2005 and changes during the years ending on those dates is presented below:

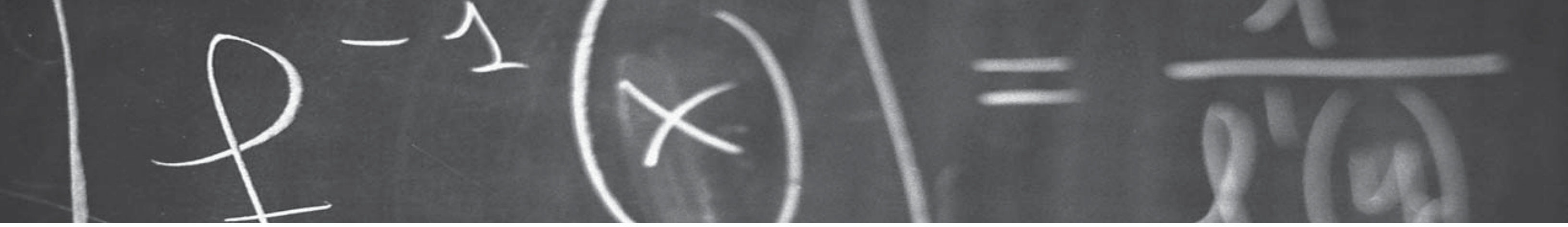
	Number of options	Weighted average exercise price
Balance, March 31, 2004	3,932,927	$ 2.75
Granted	1,460,000	0.80
Exercised	(172,750)	0.28
Cancelled	(1,604,000)	2.52
Balance, March 31, 2005	3,616,177	2.35
Granted	610,000	0.80
Cancelled	(1,761,177)	2.58
Balance, March 31, 2006	2,465,000	$ 1.80

The Company granted 615,000 performance options in fiscal 2005 subject to certain performance criteria. At March 31, 2005, these performance criteria were not met and, as a result, the performance options were cancelled in 2006.

The following table summarizes information about the total number of stock options outstanding at March 31, 2006:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding at March 31, 2006	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at March 31, 2006	Weighted average exercise price
		(years)			
$0.00 to $0.99	500,000	4.50	$ 0.77	75,000	$ 0.70
$1.00 to $1.99	890,000	3.47	1.17	785,000	1.18
$2.00 to $2.99	475,000	1.78	2.22	475,000	2.22
$3.00 to $3.50	600,000	1.76	3.28	600,000	3.28
	2,465,000	2.94	$ 1.80	1,935,000	$ 2.07

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)



8. Share capital (continued):

(c) Share purchase options (continued):

During the year ended March 31, 2006, $78,299 (March 31, 2005 - $296,044) compensation costs were recorded in the consolidated statement of operations and retained earnings (deficit) for options granted to employees in accordance with the revised CICA Handbook Section 3870.

The compensation costs recorded in the March 31, 2006 consolidated statement of operations and retained earnings (deficit) were calculated using the Black-Scholes option-pricing model using the following weighted average assumptions:

	2006	2005
Risk free interest rate	2.34%	2.05%
Expected dividend yield	0%	0%
Stock price volatility	63.35%	60.83%
Expected life of options	3.41 years	2.42 years

The weighted average fair value of options granted during the year ended March 31, 2006 is $0.45 (2005 - $0.42).

(d) Contributed surplus:

Balance, March 31, 2004	$	-
Adjustment for change in accounting policy for stock-based compensation (note 1(k))		767,252
Stock-based compensation		296,044
Balance, March 31, 2005	$	1,063,296
Stock-based compensation		78,299
Shares repurchased and cancelled at a price lower than average carrying value		879,297
Balance, March 31, 2006	$	2,020,892

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

9. Other income:

The Company is party to a Patent License Agreement through its subsidiary, ACD Systems of America, Inc. On August 31, 2004, the Company received notification from the patent holder of an underpayment of royalties.

At March 31, 2005, the Company included in other expenses on the consolidated statement of operations and retained earnings (deficit) an accrual of $266,112 which represented management's estimate of the likely costs for the underpayment of royalties, interest and penalties. At June 30, 2005, the estimate was reduced by $153,200 to reflect the final settlement. Further, as the liability primarily related to periods prior to the subsidiary being acquired, the Company was partly indemnified by previous owners against such liabilities. As a result, the Company recovered 95,158 shares valued at $86,449 as settlement of the indemnity on August 1, 2005.

10. Contingent liabilities:

The Company, in the normal course of business, has been referred to in various other claims and potential claims.

Management and their legal counsel have reviewed these claims and potential claims. Provisions have been made in the consolidated financial statements with respect to the settlement of these claims and other matters based on management's best estimates of the settlement amounts. Although management believes the accruals are sufficient to cover the settlement of these claims and potential claims, the outcome is not determinable until settled.

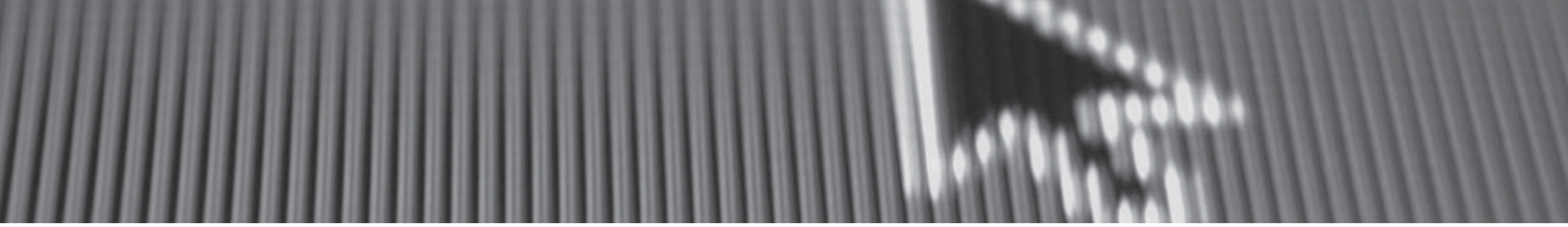
11. Earnings per share:

In 2006, 2,465,000 (2005 - 3,616,177) options have been excluded from the calculation of diluted earnings per share as the effect of these options would be anti-dilutive.

12. Commitments:

Committed minimum payments under operating leases for premises are estimated as follows:

2007	$ 726,343
2008	331,261
2009	166,805
2010	55,804
2011	37,202
Thereafter	-
	$ 1,317,415



ACD Systems International Inc.

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)
Years ended March 31, 2006 and 2005

13. Segmented information:

The Company operates in two reportable operating segments; the first segment is the design, development, marketing and support of digital imaging software and the second segment is the design, development, marketing and support of technical drawing software. These reportable operating segments derive their revenue from the sale of ACDSee™ and Canvas™ respectively. Net revenue is attributable to geographic location based on the location of the customer, as follows:

	2006	2005
United States	$ 6,757,790	$ 8,214,127
Europe	6,466,973	8,469,895
Asia	3,721,920	5,677,697
Other International	547,466	732,404
Canada	659,829	777,773
	$ 18,153,978	$ 23,871,896

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

13. Segmented information (continued):

2006	Digital imaging software	Corporate	Technical drawing software	Total
Revenue	$ 13,662,948	$ -	$ 4,491,030	$ 18,153,978
Cost of sales	2,379,499	-	520,372	2,899,871
Gross profit	11,283,449	-	3,970,658	15,254,107
Operating expenses:				
Sales, marketing and customer service	6,787,909	-	1,859,091	8,647,000
Research and development	3,269,126	-	1,636,945	4,906,071
General and administrative	2,728,990	1,870,360	781,032	5,380,382
Foreign currency losses	340,250	62,083	41,480	443,813
Amortization:				
Equipment and leasehold improvements	347,845	-	45,573	393,418
Intangible assets	58,748	-	1,752,872	1,811,620
	13,532,868	1,932,443	6,116,993	21,582,304
Operating loss	(2,249,419)	(1,932,443)	(2,146,335)	(6,328,197)
Other income (expense):				
Goodwill impairment loss	-	-	(3,559,162)	(3,559,162)
Interest income	63,747	339,548	3,752	407,047
Other	(33,871)	-	249,272	215,401
	29,876	339,548	(3,306,138)	(2,936,714)
Loss before income taxes	(2,219,543)	(1,592,895)	(5,452,473)	(9,264,911)
Income taxes (recovery):				
Current	(135)	(290)	93,420	92,995
Future	(10,511)	1,118,986	(844,162)	264,313
	(10,646)	1,118,696	(750,742)	357,308
Net loss	$ (2,208,897)	$(2,711,591)	$ (4,701,731)	$ (9,622,219)

2006	Digital imaging software	Corporate	Technical drawing software	Total
Intangible assets	$ 41,810	$ -	$ 3,650,652	$ 3,692,462

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

13. Segmented information (continued):

2005	Digital imaging software	Corporate	Technical drawing software	Total
Revenue	$ 19,301,860	$ -	$ 4,570,036	$ 23,871,896
Cost of sales	3,137,464	-	513,848	3,651,312
Gross profit	16,164,396	-	4,056,188	20,220,584
Operating expenses:				
Sales, marketing and customer service	6,256,481	-	1,921,798	8,178,279
Research and development	3,119,339	-	2,851,492	5,970,831
General and administrative	2,898,812	1,359,245	921,827	5,179,884
Foreign currency (gains) losses	(192,588)	337,952	68,036	213,400
Amortization:				
Equipment and leasehold improvements	574,924	-	55,136	630,060
Intangible assets	57,668	-	1,812,647	1,870,315
	12,714,636	1,697,197	7,630,936	22,042,769
Operating income (loss)	3,449,760	(1,697,197)	(3,574,748)	(1,822,185)
Other income (expense):				
Interest income	38,403	286,747	330	325,480
Other	(47,921)	(82)	(266,225)	(314,228)
	(9,518)	286,665	(265,895)	11,252
Earnings (loss) before income taxes	3,440,242	(1,410,532)	(3,840,643)	(1,810,933)
Income taxes (recovery):				
Current	(874,058)	(20,376)	(264,952)	(1,159,386)
Future	866,491	(930,483)	(372,597)	(436,589)
	(7,567)	(950,859)	(637,549)	(1,595,975)
Net earnings (loss)	$ 3,447,809	$ (459,673)	$ (3,203,094)	$ (214,958)

2005	Digital imaging software	Corporate	Technical drawing software	Total
Intangible assets	$ 50,782	$ -	$ 5,400,774	$ 5,451,556
Goodwill	-	-	3,559,162	3,559,162

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

14. Reconciliation to United States generally accepted accounting principles:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP") which differ in certain respects from those principles and practices that the Company would have followed had its consolidated financial statements been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP"). The material measurement differences to the consolidated financial statements are as follows:

(a) Net earnings (loss) and earnings (loss) per share:

	2006	2005
Net earnings (loss), determined under Canadian GAAP	$ (9,622,219)	$ (214,958)
Add back of employee stock-based compensation under Canadian GAAP	78,299	296,044
Recovery for stock-based compensation relating to stock options issued to employees (note 14(d))	2,400	162,960
Net earnings (loss), determined under US GAAP	$ (9,541,520)	$ 244,046
Weighted average number of common shares outstanding under US GAAP:		
Basic	22,268,324	23,665,555
Diluted	22,268,324	23,759,271
Earnings per share under US GAAP:		
Basic and diluted	$ (0.43)	$ 0.01

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

14. Reconciliation to United States generally accepted accounting principles (continued):

(b) Balance sheet:

	2006	2005
Assets		
Total assets, determined under Canadian GAAP	$ 24,931,734	$ 38,059,621
Liabilities		
Total liabilities, determined under Canadian GAAP	$ 6,739,328	$ 8,439,247
Shareholders' Equity		
Share capital and contributed surplus:		
As determined under Canadian GAAP	$ 26,745,277	$ 28,549,161
Reduction of contributed surplus for employee stock-based compensation expense under Canadian GAAP	(374,343)	(296,044)
Stock-based compensation cost (note 14(d))	9,544,325	9,546,725
Release of performance escrowed shares (note 14(e))	62,011,649	62,011,649
Share capital, determined under US GAAP	97,926,908	99,811,491
Retained earnings:		
As determined under Canadian GAAP	(8,552,871)	1,071,213
Cumulative impact of adjustments to prior years' net earnings for US GAAP differences	(71,262,330)	(71,721,334)
Current year adjustment to net earnings under US GAAP	80,699	459,004
Closing deficit, determined under US GAAP	(79,734,502)	(70,191,117)
Shareholders' equity, determined under US GAAP	$ 18,192,406	$ 29,620,374

14. Reconciliation to United States generally accepted accounting principles (continued):

(c) Income taxes:

Under US GAAP, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Under Canadian GAAP, the effect of a change in tax rates is recognized in the period of substantive enactment. The application of this difference under US GAAP does not result in a material difference between future income taxes as recorded under Canadian GAAP.

(d) Stock-based compensation:

The Financial Accounting Standards Board in the U.S. has issued Statement of Financial Accounting Standards No. 123, *"Accounting for Stock-Based Compensation"* ("FAS 123") which became effective for transactions entered into after December 15, 1995. The statement encourages entities to adopt a fair value methodology of accounting for employee stock-based compensation. As permitted by the statement, the Company has elected to continue measuring employee compensation costs using the intrinsic value method of accounting under APB Opinion 25 and related interpretations. Under the intrinsic value based method, employee stock option compensation is determined by the excess, if any, of the quoted market value of the stock at the date of the grant over the amount an optionee must pay to acquire the stock. The excess is recognized by a charge to operations over the vesting period.

For US GAAP purposes, stock options granted to non-employees for services rendered to the Company are required to be accounted for based on the fair value of the services provided or the stock options granted as the services are performed and the options earned. The Company applies a similar accounting policy under Canadian GAAP for non-employee awards made on or after April 1, 2002. The Company has determined that the application of APB Opinion 25 and related interpretations results in an additional recovery being recorded of $2,400 (2005 - $162,960), with respect to employee stock options.

During the year ended March 31, 2003, the Company repriced 773,000 options with an exercise price of $3.50 to $1.25 per option. The Company has followed the guidance of Financial Accounting Standards Board Interpretation No. 44 ("FIN 44"), *"Accounting for Certain Transactions Involving Stock Compensation"*, which requires the use of variable accounting for repriced options. Under variable accounting, compensation cost is measured at the end of each period as the amount by which the quoted market value of the Company's shares covered by a grant exceeds the option price and should be accrued as a charge to expense over the periods the employee performs the related services. Included in the $2,400 (2005 - $162,960) is additional intrinsic value recovery of $2,400 (2005 - $162,960) attributable to repriced options as the market price at March 31, 2006 was less than the market price at the last valuation date, March 31, 2005.

Notes to Consolidated Financial Statements (Expressed in Canadian Dollars)

14. Reconciliation to United States generally accepted accounting principles (continued):

(d) Stock-based compensation (continued):

Had the Company determined compensation cost based on the fair value at the grant date for its stock options under FAS 123, the Company's net earnings (loss) would have been as follows:

	2006	2005
Net earnings (loss):		
As reported under US GAAP (note 14(a))	$ (9,541,520)	$ 244,046
Pro forma net loss	(9,622,219)	(424,105)
Earnings (loss) per share:		
As reported under US GAAP (note 14(a))		
Basic and diluted	(0.43)	0.01
Pro forma basic and diluted	(0.43)	(0.02)

The fair value of these options has been determined using the Black-Scholes option pricing formula with the following weighted average assumptions:

	2006	2005
Risk free interest rate	2.34%	2.05%
Expected dividend yield	0%	0%
Stock price volatility	63.35%	60.83%
Expected life of options	3.41 years	2.42 years

The weighted average fair value of options granted during the year ended March 31, 2006 was $0.45 (2005 - $0.42) per option.

14. Reconciliation to United States generally accepted accounting principles (continued):

    (e) Performance escrow shares:

    US GAAP requires shares releasable from performance-based escrow to be recorded at their fair value when they are eligible to release with the charge recognized in the consolidated statements of operations and retained earnings (deficit). In 2003, all remaining eligible shares were released from performance escrow results in a total additional $62,011,649 expense being recorded under US GAAP.

    (f) Recent accounting pronouncements:

    In December 2004, the Financial Accounting Standards Board ("FASB") issued revised Statement of Financial Accounting Standards No. 123 entitled "Share-Based Payment" ("FAS No. 123R"). FAS 123R addresses accounting for stock-based compensation and requires that the fair value of all stock-based compensation arrangements, including options, be recognized as an expense in a company's financial statements, as opposed to the presentation of supplemental pro forma disclosure in the notes to financial statements. FAS 123R eliminates the ability to account for stock-based compensation transactions using APB Opinion No. 25. FAS No. 123R is effective for public entities that do not file as small business issuers as of the beginning of the first interim or annual reporting period of the first fiscal year that begins after June 15, 2005.

    The Company is currently evaluating the impact of these recent accounting pronouncements on its consolidated financial statements.

Corporate Information

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Chairman of the Board

Inder Duggal
Board Member

Ian Mansfield
Board Member

George Mitchell
Board Member

Lee Richardson
Board Member

Hiro Uchida
Board Member

Executive Officers

Douglas Vandekerkhove
President and Chief Executive Officer

William Sequeira
Chief Operating Officer

George Mitchell
Chief Financial Officer

Transfer Agent and Registrar

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Securities Listed

Common Shares are listed for Trading on the TSX under the symbol "ASA".

ACD Systems

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